No. 87-1020

IN THE
# Supreme Court of the United States
OCTOBER TERM, 1988

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PAUL S. DAVIS,
*Appellant,*

v.

STATE OF MICHIGAN, DEPARTMENT OF THE TREASURY

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**On Appeal from the Court of Appeals of Michigan**

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## BRIEF *AMICUS CURIAE* OF THE NATIONAL ASSOCIATION OF RETIRED FEDERAL EMPLOYEES IN SUPPORT OF APPELLANT

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## QUESTION PRESENTED

Whether the State of Michigan, in the application of its income tax laws, may discriminate against federal annuitants and accord them less favorable treatment than that which it affords its state and local government annuitants.

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The National Association of Retired Federal Employees ("NARFE") submits this brief *amicus curiae* to urge that the Court reverse the decision below and invalidate Michigan's income tax law that discriminates against federal annuitants.

### INTEREST OF NARFE

NARFE is a nonprofit, incorporated association having its principal place of business in Washington, D.C. From its original fourteen charter members, NARFE has

grown to a membership now exceeding half a million federal annuitants (retirees and survivors) living throughout the 50 states, Puerto Rico, the Canal Zone, the Republic of the Philippines, and various foreign countries. NARFE has been a major advocate in maintaining the integrity of the federal government's civilian retirement systems and has been directly involved, through lobbying and related activities, in all legislative and executive changes in these systems over the past six decades.

NARFE has concerned itself with issues affecting the aged and aging, and in particular those issues that affect federal annuitants. NARFE's goal is to identify issues of particular importance to federal annuitants, to inform them, through its Newsletter and the state and local chapter network, of these issues, and to act upon these issues to further the members' common goals. NARFE also assists federal annuitants in obtaining benefits to which they may be entitled under the retirement laws by interacting with various federal agencies and private entities on such matters as federal annuities and health and life insurance benefits.

This case presents questions calling for application of the Supremacy Clause of the Constitution and implicating the doctrine of intergovernmental tax immunity. Under Michigan law, annuities paid by the state, or local governments within the state, are exempt from state income tax. Annuities paid by the federal government are only partially exempted from such taxation and are fully taxed past a certain threshold level. Thus, federal annuitants are accorded less favorable treatment than Michigan state and local government annuitants, and indeed, annuitants of other state and local governments whose states provide a reciprocal exemption for Michigan annuities.

Michigan is not unique among the states in so discriminating against federal annuitants. Several other states, including, for example, Arizona, Arkansas, Georgia, New York and Virginia, similarly accord preferential treatment to annuitants of their own state and local governments.[1] Because this Court's decision will affect federal annuitants in these and other states throughout the country, NARFE has obtained the consent of the parties to participate in this matter as *amicus curiae*.[2]



## ARGUMENT

Michigan's income tax law according preferential treatment to state and local annuitants *vis-a-vis* federal annuitants is invalid under the Supremacy Clause of the Constitution. Foremost, this law is superseded by 4 U.S.C. § 111, which authorizes the states to tax compensation of employees of the United States "if the taxation does not discriminate against the officer or employee because of [its] source . . ." Annuities received by federal retirees are deferred compensation for past services rendered. The Michigan statute, which would grant the exemption to federal annuitants but for the fact of its source, plainly contravenes 4 U.S.C. § 111.

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[1] *See* Ariz. Rev. Stat. Ann. § 43-1022(3), (4) (annuities of retired state employees are wholly exempt from taxation; only the first $2,500 of income from a federal annuity is exempt); Ark. Stat. Ann. § 26-51-307(a), (b) (1987) (retirement benefits of state employees who retire before December 31, 1989 are wholly exempt from taxation; after that date state annuitants will be treated the same as federal annuitants, and may exempt only the first $6,000 of retirement benefits); Ga. Code § 48-7-27(a)(4) (exempting only state employees' annuities and retirement benefits from taxation); N.Y. Tax Law § 612(c)(3) (wholly exempting state employees' pensions from taxation); Va. Code § 58.1-322.C.3 (exempting Commonwealth employees' retirement income from taxation). *Contra* Ala. Code § 40-18-19(a) (exempting from taxation income received from federal and state employees' annuities); Kan. Stat. Ann. § 79-32,117(c) (exempting income received as federal civil service employee annuity).

[2] Counsel for appellant and appellee have consented to the filing of this brief. Their letters have been filed with the Clerk pursuant to Rule 36.2 of the Rules of this Court.

Moreover, Michigan's statute violates the doctrine of intergovernmental tax immunity embodied in the Supremacy Clause. Of course, since this case can be resolved on statutory grounds, this Court need not reach this constitutional issue. Nonetheless, the intergovernmental tax immunity component of the Supremacy Clause prohibits any state from imposing a tax that discriminates against the federal government or those with whom the government deals. Michigan's tax law favors its own annuitants at the expense of federal annuitants. This the Constitution forbids.

**A. Michigan's Discriminatory Tax Violates 4 U.S.C. § 111**

It is, of course, axiomatic that under the Supremacy Clause (Art. VI, Cl. 2) a state measure that conflicts with a federal statute must yield. *McCulloch* v. *Maryland*, 17 U.S. 316, 406 (1819); *Swift & Co.* v. *Wickham*, 382 U.S. 111 (1965). This is so where there is a conflict between federal law and the application of an otherwise valid state enactment, no less than where there is a clear collision between the text of federal and state statutes. *Hamm* v. *City of Rock Hill*, 379 U.S. 306 (1964).

The state law at issue here (Mich. Comp. Laws Ann. § 206.30(1)(h) (West 1986 & Supp. 1988); Mich. Stat. Ann. § 7.557(130) (Callahan 1984)) concededly discriminates against federal retirees and in favor of Michigan state and local governmental retirees. This is expressly accomplished in the state internal revenue code through an "adjustment" to the definition of "taxable income" that excludes completely from state taxation "[r]etirement or pension benefits received from a public retirement system of or created by an act of this state or a political subdivision of this state." Mich. Stat. Ann. § 7.557(130)(1)(h)(i).

This same benefit is made available on a reciprocal basis for public pensions and the like that derive from other states or their subdivisions. Mich. Stat. Ann.



§ 7.557(130)(1)(h)(ii). However, pensions and retirement benefits received from all other sources, including federal retirement benefits, are deductible only up to $7,500 for a single return and $10,000 for a joint return. Mich. Stat. Ann. § 7.557(130)(1)(h)(iii).

Thus, Michigan's tax law treats federal pensions and retirement benefits less favorably than those that have Michigan state or its subdivisions as their source. This differential treatment plainly runs afoul of 4 U.S.C. § 111, and because this is a federal measure, and therefore supreme, the state enactment must give way.

The Court of Appeals of Michigan reasoned that 4 U.S.C. § 111 was inapposite because "a retired federal civil service employee is not to be considered an employee for civil service purposes." J.S. App. A4-A5. Yet there is nothing in the statute that limits the ban on discrimination solely to those employees who are working at the time of the taxation. The state court's construction to so restrict 4 U.S.C. § 111 is plainly wrong.

On its face, the statute prohibits discrimination in the taxation of "compensation for personal service as an officer or employee of the United States . . . because of the source of the pay or compensation." The statute incorporates no temporal limitation, nor does it impose any requirement that the compensation be paid while the person is actually serving as an employee. This is plain from the face of the statute, and there is no suggestion that a contrary intent was expressed in the enactment's reported history.

Thus, Michigan's discriminatory tax law could only survive 4 U.S.C. § 111 if the retirement benefits at issue here were other than "pay or compensation for personal service as an officer or employee of the United States." Yet Congress intended, and the courts have recognized, that federal civil service retirement benefits are deferred compensation which are earned "for personal service as

an officer or employee of the United States" in the same way that basic pay by federal officers and employees is earned.

That the benefits earned under the federal retirement system were to be treated as compensation was signaled early in the debates surrounding the original Retirement Act of 1920. Representative Hammil, one of the active proponents of the legislation, made the point as follows:

> This pension bill must not be regarded as governmental generosity. Pensions are not gratuities, and they should not be considered as such. They should be looked upon as deferred wages—as payments of wages which were not disbursed at the time when they were earned.

59 Cong. Rec. H6300 (daily ed. April 29, 1920) (statement of Rep. Hammil). In a similar vein, Representative Mann, another of the proponents of the legislation, noted that the benefit received under the retirement legislation "is part and parcel of the subject of the wage you pay." 59 Cong. Rec. H6378 (daily ed. April 30, 1920) (statement of Rep. Mann).

Recognition that federal retirement benefits are merely a deferred form of compensation has persisted from the system's original enactment through the various Congresses that from time-to-time have amended the law. Thus, Representative Withrow in 1952 noted that "we all want to provide relief to the retired employees, not as a gratuity but as a matter of right." 98 Cong. Rec. H8969 (daily ed. July 2, 1952) (statement of Rep. Withrow). Later, in 1958, Representative Cederberg quoted the Director of the Bureau of the Budget: "[t]he Retirement Act promises to make certain payments under specified conditions . . . [and there] are no conditions attached. It is a perfectly open and straight-forward obligation." 104 Cong. Rec. H5825 (daily ed. March 31, 1958) (statement of Rep. Cederberg).



The pertinent statutory provision also confirms that Congress conceived and established retirement benefits as deferred compensation. More specifically, 5 U.S.C. § 8334 (b) provides as follows:

> Each employee or Member is deemed to consent and agree to these deductions from basic pay. Notwithstanding any law or regulation affecting the pay of an employee or member, payment less these deductions is a full and complete discharge and acquittance of all claims and demands for regular services during the period covered by the payment, *except the right to the benefits to which the employee or Member is entitled under this subchapter.*

(Emphasis added).

This language derives from Section 9 of the original Civil Service Retirement Act, enacted May 12, 1920, 41 Stat. 614:

> That every employee coming within the provisions of this Act shall be deemed to consent and agree to the deductions from salary, pay, or compensation as provided in section 8 hereof, and payment less such deductions shall be a full and complete discharge and acquittance of all claims and demands whatsoever for all regular services rendered by such employee during the period covered by such payment, *except the right to the benefits to which he or she shall be entitled under the provisions of this Act . . .*

(Emphasis added.)

The language of Section 9, as that of the successor formulation, is plain. It conveys clearly that the retirement benefits for which an employee qualifies are deferred compensation. Part of an employee's compensation is paid to him or her at the time the service is performed. While part of the salary is withheld as retirement deductions, compensation continues to be paid until the employee ceases to receive retirement benefits.

The Civil Service Retirement Act has been amended many times since its original enactment in 1920. *See, e.g.*, 44 Stat. 904; 47 Stat. 1489; 52 Stat. 943; 56 Stat. 13; 59 Stat. 411; 60 Stat. 939; 62 Stat. 504; 63 Stat. 609; 70 Stat. 532; 74 Stat. 358; 76 Stat. 832; 80 Stat. 288; 83 Stat. 136. At all times and in all versions the Act has contained language that has the same meaning as the original Section 9 and includes the same guarantee of retirement benefits as part of compensation. Thus Congress has consistently recognized federal annuities as part and parcel of the compensation paid to government officers and employees.

On the basis of the foregoing, it cannot be disputed that federal retirement benefits are earned compensation, alike in every respect to basic wages except that retirement compensation is deferred. *See also Kizas* v. *Webster*, 707 F.2d 524, 535-36 (D.C. Cir. 1983), *cert. denied*, 464 U.S. 1042 (1984) (characterizing federal retirement benefits as one of the "incidents of employee compensation"). Accordingly, 4 U.S.C. § 111 is directly implicated. As with the basic wages of federal employees, Congress has mandated that retirement benefits, too, cannot be discriminatorily taxed by state or local jurisdictions. Since this is precisely the practice the Michigan appeals court found to be sanctioned by the state law at issue here, that state law must yield under the well-established principles of federal law supremacy.

### B. Michigan's Discriminatory Tax Violates The Intergovernmental Tax Immunity Doctrine

It is a "fundamental rule of judicial restraint" that before reaching "any constitutional questions, federal courts must consider nonconstitutional grounds for decision." *Jean* v. *Nelson*, 472 U.S. 846, 854 (1985), *quoting Gulf Oil Co.* v. *Bernard*, 452 U.S. 89, 99 (1981) and *Three Affiliated Tribes of the Fort Berthold Reservation*



v. *World Engineering*, P.C., 467 U.S. 138, 157 (1984). Indeed, "[i]f there is one doctrine more deeply rooted than any other in the process of constitutional adjudication, it is that [courts] ought not to pass on questions of constitutionality . . . unless such adjudication is unavoidable." *Jean* v. *Nelson*, 472 U.S. at 854, *quoting Spector Motor Service, Inc.* v. *McGaughlin*, 323 U.S. 101, 105 (1944). We submit that this case can be easily resolved on statutory grounds, *i.e.*, that Michigan's preferential tax statute violates the mandate of 4 U.S.C. § 111, and thus this Court need not reach the constitutional issue presented here. Nonetheless, Michigan's tax preference law does violate the intergovernmental tax immunity doctrine of the Supremacy Clause and is invalid on this basis as well.

Although its application has often in the past proven problematic, the basic tenet of the intergovernmental tax immunity doctrine is straightforward: a state may not impose a tax which discriminates against the federal government or "upon those with whom it deals." *Moses Lake Homes, Inc.* v. *Grant County*, 365 U.S. 744, 751 (1961), *quoting United States* v. *City of Detroit*, 355 U.S. 466, 473 (1958). Michigan's tax taps compensation of former employees of the federal government while excluding the identical income from state and local sources. Even if Congress had fashioned federal annuities as other than deferred compensation, plainly federal annuitants are persons "with whom the government deals." Accordingly, there can be no dispute that Michigan's tax infringes this basic component of the Supremacy Clause.

To be sure, Michigan may have a "rational basis" for its differentiation between state and local annuitants and other retirees. But Equal Protection analysis in inapposite where, as here, the State has trespassed the Supremacy Clause of the Constitution. *Phillips Chemical Co.* v. *Dumas Independent School District*, 361 U.S. 376, 385 (1960). Rather, Michigan's discriminatory tax could survive, if at all, only upon demonstration of a significant

and compelling need for the discriminatory treatment. *Id.*, 361 U.S. at 383. Michigan's minimal assertion of a "rational basis" does not satisfy this more exacting standard.

Similarly, Michigan's statute is not saved by the fact that it treats federal annuities equally as poorly as it treats all other non-Michigan annuities. In *Memphis Bank & Trust Co.* v. *Garner*, 459 U.S. 392, 398-99 (1983), this Court rejected the analogous argument that Tennessee's bank tax was nondiscriminatory because it treated federal obligations the same as private ones, according preferential treatment only to obligations of Tennessee and its political subdivisions. *See also Phillips Chemical Co.*, 361 U.S. at 381-82 (noting that the absence of discrimination between the federal government and private parties did not save a statute that imposed lesser tax burdens on lessees of state property). Intergovernmental tax immunity requires a state to treat the federal government, and those with whom it deals, no less favorably than it treats itself. This Michigan plainly has failed to do. Accordingly, its discriminatory tax must be stricken.

## CONCLUSION

For the foregoing reasons, the decision of the court below must be reversed.

Respectfully submitted,

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